

## Message Text

CONFIDENTIAL

PAGE 01 LISBON 06203 01 OF 03 101513Z

46

ACTION EUR-12

INFO OCT-01 ISO-00 AF-08 OPIC-03 SAM-01 EURE-00 SSO-00

NSCE-00 USIE-00 INRE-00 SP-02 AID-05 EB-07 NSC-05

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C O N F I D E N T I A L SECTION 1 OF 3 LISBON 6203

DEPARTMENT PASS DEPARTMENT OF TREASURY

E.O. 11652: GDS

TAGS: ECON, PO, EFIN

SUBJECT: PRIME MINISTER DISCUSSES ECONOMIC CRISIS

SUMMARY. PRIME MINISTER SOARES DELIVERED LONG-AWAITED ECONOMIC  
SPEECH ON SEPTEMBER 9. AFTER PROVIDING REALISTIC ANALYSIS OF  
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PAGE 02 LISBON 06203 01 OF 03 101513Z

ECONOMY, HE DISCUSSED SERIES OF TOUGH POLICIES WHICH HE

DECLARED MUST BE ADOPTED TO SOLVE ECONOMIC CRISIS AND TO SAVE DEMOCRACY. HE CONCENTRATED HEAVILY ON LABOR SECTOR AS CAUSE OF ECONOMIC WOES. AS IN PAST, HOWEVER, SPEECH WAS SHORT ON DETAILS AS PRIME MINISTER ANNOUNCED FEW IMMEDIATE SPECIFIC MEASURES. IMPORT SURCHARGE WILL BE AUGMENTED; WAGE INCREASES WILL BE LIMITED BEGINNING JANUARY 1, 1977, WHEN MINIMUM WAGE WILL BE REVISED; WILDCAT STRIKES MUST STOP; AND THIRTEENTH MONTH SALARY PAYMENT WILL BE PAID PARTIALLY IN GOP BONDS. SPEECH, WHICH BEGAN ON EXCELLENT NOTE OF DETERMINATION, WAS DISAPPOINTING IN ITS DEARTH OF IMMEDIATE MEASURES. IT MAY STRENGTHEN GROWING IMPRESSION HERE THAT GOP IS TEMPORIZING. NEVERTHELESS, MEASURES THAT WERE ANNOUNCED HAVE ALREADY SPARKED COMMUNIST CRITICISM, AT SAME TIME THAT MILITARY OPERATIONALS ARE CRITICIZING ADMINISTRATION FOR NOT ADOPTING HARSHER MEASURES. END SUMMARY.

1. ON SEPTEMBER 9 PRIME MINISTER MARIO SOARES DELIVERED LONG-AWAITED TV SPEECH OUTLINING PORTUGAL'S ECONOMIC CRISIS. SOARES ANNOUNCED SEVERAL IMMEDIATE MEASURES AND PROMISED ADDITIONAL REFORM LEGISLATION. PRIME MINISTER PRESENTED BLEAK ECONOMIC PICTURE. HE NOTED THAT COUNTRY HAS DISSIPATED 80 PERCENT OF ITS FOREIGN EXCHANGE RESERVES AND INCREASED FOREIGN DEBT TO \$3.06 BILLION. INSTEAD OF INCREASING ECONOMIC INDEPENDENCE, PAST POLICIES HAVE MADE ONE-THIRD OF ECONOMY DEPENDENT ON FOREIGN TRADE. BALANCE OF PAYMENTS DEFICIT IN 1976 WILL APPROACH \$1 BILLION. PUBLIC SECTOR DEFICIT THIS YEAR WILL BE \$2.25 BILLION, INCLUDING \$1.29 BILLION CENTRAL GOVERNMENT DEFICIT. (COMMENT: SOARES' FIGURES ON BALANCE OF PAYMENTS DEFICIT ARE CONSIDERABLY LOWER THAN BANK OF PORTUGAL AND OUR PROJECTIONS - SEE LISBON 4347.) CONTINUATION OF THIS TREND, HE STRESSED, WOULD SOON TERMINATE PORTUGAL'S NASCENT DEMOCRACY.

2. SOARES REFERRED TO WIDESPREAD EXPECTATIONS OF SEVERE AUSTERITY MEASURES BY NOTING THAT DISCREET AND EFFECTIVE ACTIONS WHICH GOVERNMENT HAS BEEN MAKING ARE MORE IMPORTANT THAN "LONG LISTS OF SPECTACULAR MEASURES," FOLLOWING IS SUMMARY:

A. LABOR: FOR ECONOMIC RECOVERY, WORK IS FAR MORE  
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PAGE 03 LISBON 06203 01 OF 03 101513Z

IMPORTANT THAN GOLD. REVOLUTION HAS BENEFITED 700,000 WORKERS IN INDUSTRIAL BELTS, BUT HAS NOT ASSISTED MILLIONS OF OTHER WORKERS. ABSENTEEISM MUST BE CURBED, "POLITICAL" MEETINGS BANNED DURING WORK HOURS, AND PRODUCTION INCREASED. WORKERS MUST BE PENALIZED FOR POOR PERFORMANCE. COMPANIES DO NOT HAVE TO PAY WORKERS WHO ARE ON STRIKE.

-- MEASURES PROMISED:

- REVISED LAW ON DISMISSEALS FOR JUST CAUSE;
- REVISED COLLECTIVE CONTRACT LAW;
- LAW ESTABLISHING NATIONAL WORK WEEK  
AND LIMITING OVERTIME; AND
- REVOCATION OF LAW WHICH ALLOWED ONLY ONE  
NATIONAL UNION CONFEDERATION.

B. MONETARY POLICY: RESTRICTIVE CREDIT POLICY WOULD  
AGGRAVATE DEPRESSION IN SOME SECTORS, BUT GOP MUST CONTROL  
MONETARY GROWTH AND CHANNEL RESOURCES TO PRIORITY  
INVESTMENTS.

- MEASURES TO BE ANNOUNCED:
- MORE SELECTIVE CREDIT POLICY, REVIEWED INTEREST  
RATES, SPECIAL CREDIT LINES FOR SELECTED  
SECTORS;
- REVISED BANK RESERVE REQUIREMENTS;
- DYNAMICATION CAPITAL MARKET;
- MORE ATTRACTIVE EMIGRANT SAVINGS PROGRAM; AND
- MEASURES AGAINST ESCUDO BLACK MARKET.

C. INCOMES AND PRICES: SALARY DISPARITIES MUST BE  
REDUCED, AND MULTIPLE EMPLOYMENT LIMITED. PRICES MUST  
BE REVISED TO REFLECT COSTS, WITHOUT PROMOTING UNCONTROLLED  
INFLATION. PRICES OF ESSENTIAL GOODS TO BE "GUARANTEED"  
FOR NEXT 12 MONTHS. INCOMES AND PRICES VOUNCIL WILL  
SET NORMS FOR PRICE INCREASES.

- MEASURES TO BE IMPLEMENTED:
- CREATION OF NATIONAL INCOMES AND PRICES COUNCIL;
- INCREASED TRANSPORTATION FARES;
- INCREASE IN MINIMUM WAGE (AFTER JANUARY 1, 1977);
- RESTRAINT ON SALARY INCREASES;
- LIMIT OF 15 PERCENT ON INCREASE OF TOTAL  
WAGE BILL FOR PUBLIC SECTOR;
- INCREASE IN LOWEST PENSIONS (IF POSSIBLE BY END  
OF 1976); AND

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PAGE 04 LISBON 06203 01 OF 03 101513Z

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PAGE 01 LISBON 06203 02 OF 03 101526Z

46

ACTION EUR-12

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CONFIDENTIAL SECTION 2 OF 3 LISBON 6203

- CHRISTMAS BONUSES (13TH MONTH SALARY) EXCEEDING \$160 TO BE PAID IN GOVERNMENT BONDS, WHICH IN TURN CAN BE USED AS COLLATERAL FOR HOUSING LOANS.

D. FOREIGN TRADE: PAYMENTS DEFICIT STEMS BASICALLY FROM DEFICIENT PRODUCTION STRUCTURE AND INCREASED CONSUMPTION.

- MEASURES TO BE ADOPTED:

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PAGE 02 LISBON 06203 02 OF 03 101526Z

- TEMPORARY INCREASE (OF 20 TO 30 PERCENT) IN IMPORT SURCHARGE;  
- RESTRICTION ON IMPORT OF NON-ESSENTIAL GOODS;  
- EXPORT STIMULATION MEASURES - E.G. PREFERENTIAL INTEREST RATES FOR EXPORT CREDITS;  
- ESTABLISHMENT OF FOREIGN EXCHANGE BUDGET FOR PUBLIC SECTOR WHILE PROMOTING IMPORT SUBSTITUTION, AND  
- SELECTIVE RATIONING OF SOME GOODS.

E. BUDGET POLICY: ALTHOUGH GOP CANNOT SUBSTANTIALLY REDUCE DEFICIT IN REST OF 1976, IT WILL STRIVE TO DO SO IN 1977.

- MEASURES ALREADY TAKEN:

- CONTAINMENT OF SPENDING INCREASES NOT COVERED BY INCREASED RECEIPTS; AND
- LIMITATION ON STATE GUARANTEES AND SUBSIDIES.

F. INVESTMENT PROGRAM: GOP SHORTLY WILL PAY ALL ITS DOMESTIC CREDITORS AND PROVIDE FINANCING FOR HUNDREDS OF PROJECTS OF SMALL AND MEDIUM COMPANIES. PUBLIC WORKS PROGRAM WILL APPROACH \$800 MILLION THIS YEAR. TRANSPORTS AND COMMUNICATIONS ARE SPENDING MORE THAN \$320 MILLION ON NEW EQUIPMENT. FOREIGN INVESTMENT CODE WILL BE AMENDED.

G. TAX POLICY:

- MEASURES ANNOUNCED:
- ALLOWANCE FOR INSTALLMENT PAYMENTS;
- EXTENSION OF TIME LIMIT FOR PAYMENT OF 1975 COMPLEMENTARY (INCOME) TAX; AND
- CREATION OF SYSTEM OF PERSONAL CREDIT FOR TAX PAYMENT GUARANTEED BY SALARY OR SHARES OF NATIONALIZED COMPANIES.

H. HOUSING AND EDUCATION: RIGHT TO PROPERTY HAS TO BE RECONCILED WITH RIGHT TO HOUSING. GOP WILL NOT PERMIT FURTHER HOUSE OCCUPATIONS, BUT WILL ATTEMPT TO FIND SOLUTION FOR NEEDIEST CASES. GOP IS STUDYING VARIOUS MEASURES TO REFORM EDUCATIONAL SYSTEM, ESPECIALLY HIGHER EDUCATION.

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PAGE 03 LISBON 06203 02 OF 03 101526Z

-- MEASURES PROMISED:

- LAND LAW (BY END OF SEPTEMBER) TO STIMULATE PUBLIC HOUSING CONSTRUCTION;
- REVISED LAW ON URBAN RENTALS INCREASING GUARANTEES TO LANDLORDS; AND
- NEW LAW ON MANAGEMENT OF PRIMARY AND SECONDARY EDUCATION.

I. AGRARIAN REFORM: IF IMPLEMENTATION NOT RAPIDLY CORRECTED, ALENTEJO REGION WILL CONTINUE TOWARD ECONOMIC COLLAPSE. GOP WILL HAVE TO DEVELOP METHODS OF AUDITING FARM ACCOUNTS, "MANAGERIAL DEMOCRACY", AND PRODUCTION PLANS. FARM UNITS WILL HAVE TO PRESENT ACCOUNTS TO RECEIVE CREDITS. AGRICULTURAL WORKERS' UNION WILL NOT BE ALLOWED TO CONTROL HIRINGS.

J. PUBLIC SECTOR POLICY: GOP IS REORGANIZING PUBLIC SECTOR. NATIONALIZED COMPANIES HAVE TO BECOME PROFITABLE. STATUTE OF MANAGEMENT FOR PUBLIC ENTERPRISES WILL BE PRESENTED BY OCTOBER 15.

K. PUBLIC ORDER: CAMPAIGN OF AGITATION HAS BEEN UNDERWAY SINCE AUGUST. MEDIA HAVE IRRESPONSIBLY PLAYED UP LABOR DISPUTES. SECURITY FORCES WILL BACK UP DEMOCRATIC LEGALITY. CLEANING OF CITIES WILL BE INTENSIFIED.

-- MEASURES PROMISED:

- REORGANIZATION OF JUDICIARY POLICE;
- CAMPAIGN AGAINST DRUGS, INCLUDING ESTABLISHMENT OF THREE TREATMENT CENTERS;
- LAW CONTROLLING SIDEWALK VENDORS;
- ESTABLISHMENT OF BOARDS FOR POSTING OF POLITICAL PROPAGANDA; AND
- CAMPAIGNS TO RESTORE TRAFFIC DISCIPLINE AND TO PREVENT CONTRABAND.

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PAGE 01 LISBON 06203 03 OF 03 101539Z

47

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CONFIDENTIAL SECTION 3 OF 3 LISBON 6203

3. COMMENT: WITH ITS CLEAR, HARD-HITTING TONE AND GENERALLY OBJECTIVE ANALYSIS (SAVE CERTAIN EXAGGERATIONS OR UNDERSTATEMENT) OF THE DIFFICULT ECONOMIC SITUATION, THE SPEECH WAS ONE OF THE BEST MADE IN PORTUGAL SINCE APRIL 25, 1974. WHILE MUCH OF IT WAS A REITERATION OF SOARES' ASSEMBLY SPEECH OF EARLY AUGUST, MANY POLICY STATEMENTS WERE FURTHER DEFINED AND TOUGHENED. THE MOST POSITIVE FEATURE WAS HIS CLEAR DECLARATION THAT LABOR

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PAGE 02 LISBON 06203 03 OF 03 101539Z

ISSUES WERE PORTUGAL'S BASIC PROBLEMS. LABOR'S IMPORTANCE WAS EMPHASIZED BY ITS MENTION AT THE VERY BEGINNING OF THE SPEECH AND ITS LONG DETAILED TREATMENT. MOST SIGNIFICANT IN THIS RESPECT WAS THE CLEAR STATEMENT OF THE GOP'S INTENTION TO CONTROL THE LABOR SECTOR THROUGH SUCH PROMISED MEASURES AS CONTROL OF ABSENTEEISM AND LABOR INDISCIPLINE, CLARIFICATION OF DISMISSAL FOR CAUSE, CONTROL OVER UNJUST ECONOMIC DEMANDS BY LABOR, REDUCTION IN WAGE DISPARITIES, AND THE PROHIBITION OF WILDCAT STRIKES. ALSO SIGNIFICANT WAS THE HEAVY EMPHASIS ON RESTRUCTURING THE PUBLIC SECTOR, CORRECTION OF ABUSES IN AGRARIAN REFORM, CONTROL OF GOP EXPENDITURES AND INCREASED COLLECTION OF TAXES, AND REFORM EDUCATION. MEASURES TO REINSTITUTE RESPECT FOR AUTHORITY WERE ALSO KEY ASPECT. SOARES' EMPHASIS ON DEVELOPMENT TO COMPLEMENT THE NEED FOR AUSTERITY WAS ENCOURAGING, ALTHOUGH SOME OF INVESTMENT PROJECTS MENTIONED ARE FAR FROM START-UP OR HAVE NOT EVEN BEEN PROVED ECONOMICALLY VIABLE. FINALLY, HE STATED CLEARLY THAT THE RESOLUTION OF THE ECONOMIC CRISIS WOULD ENTAIL SACRIFICES BY ALL.

4. MOST SIGNIFICANT SPECIFIC MEASURE WAS ANNOUNCEMENT OF LIMITATION OF PUBLIC SECTOR SALARY INCREASES TO 15 PERCENT AFTER JANUARY 1, 1977, THUS PROVIDING BASIS OF INCOME POLICY. THIS WILL MEAN REAL LOSS OF INCOME TO MOST WAGE EARNERS IN 1977 BECAUSE INFLATION IS CERTAIN TO BE HIGHER THAN 15 PERCENT. LOSS WILL BE COMPOUNDED FOR SOME BY PROMISED REDUCTION IN FRINGE BENEFITS AND PERKS, BUT CARE WILL HAVE TO BE TAKEN NOT TO DRIVE ADDITIONAL TECHNICIANS OUT OF PORTUGAL. BECAUSE OF THE WIDE DISPARITY OF WAGES

AMONG COMPARABLE JOBS, THE 15 PERCENT LIMITATION WILL  
MAKE IT DIFFICULT TO FULFILL THE PROMISE OF EQUALIZING WAGES.  
IMPORT MEASURES, ESPECIALLY SURCHARGE, WILL UPSET MAJOR TRADING  
PARTNERS AND POSSIBLY INVITE RETALIATION. MORE IMPORTANTLY  
THEY WILL TEND TO CREATE VESTED INTERESTS WHICH  
WILL BE DIFFICULT TO DISLODGE LATER. IN ANY EVENT,  
SURCHARGE HAS NOT BEEN VERY SUCCESSFUL UNTIL NOW,  
ACCORDING TO GOP OFFICIALS. PARTIAL PAYMENT OF THIRTEENTH  
MONTH BONUS WITH GOP BONDS IS SIGNIFICANT AUSTERITY  
MEASURE AND WILL GENERATE IMMEDIATE ADVERSE REACTION  
FROM LABOR. DELAY TO JANUARY 1 IN IMPLEMENTATION OF WAGE  
CONFIDENTIAL

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PAGE 03 LISBON 06203 03 OF 03 101539Z

INCREASE LIMITATION WILL ALMOST CERTAINLY GENERATE TREMENDOUS  
PRESSURE FROM UNIONS FOR INCREASED CONTRACTS BEFORE THE  
END OF 1976. FORTHCOMING LOCAL ELECTIONS WILL HEIGHTEN  
GOP SENSITIVITY TO THIS PRESSURE.

5. MANY OF THE POLICIES, EVEN IN THE LABOR SECTOR,  
STILL LACK THE SPECIFICITY NECESSARY FOR IMPLEMENTATION  
AND ANALYSIS. THEY MUST BE TRANSFORMED INTO DRAFT  
LAWS AND THEN SUBMITTED AND APPROVED BY CONGRESS, A  
PROCESS WHICH MAY TAKE MONTHS. OTHER MEASURES, SUCH AS  
CONTROL OF ILLEGAL STRIKES AND NONPAYMENT FOR STRIKE  
DAYS, ARE ALREADY ON THE BOOKS AND NEED ONLY TO BE  
ENFORCED. STILL OTHERS, SUCH AS CREDIT REVISION,  
INTEREST RATE CHANGES, A FULL WAGE AND PRICE POLICY,  
LIMITATION OF IMPORTS, ETC., MUST BE SPELLED OUT IN  
GREATER DETAIL. CONSPICUOUSLY ABSENT FROM SPEECH WERE  
PROPOSALS ON EXCHANGE POLICY AND ADDITIONAL ENERGY SAVING  
MEASURES.

6. IF THE GOP CAN TRANSFORM THE GENERAL POLICY STATE-  
MENT INTO COHERENT, COMPATIBLE ECONOMIC MEASURES AND  
THEN IMPLEMENT AND ENFORCE THEM, SOARES' PROGRAM  
COULD BE THE BEGINNING OF ECONOMIC RECUPERATION.  
REALISTICALLY, HOWEVER, EXPERIENCE SHOWS THERE IS A  
SUBSTANTIAL GAP BETWEEN WORDS AND ACTIONS. EVEN  
ASSUMING THE WILL AND GOOD INTENTIONS ON PART OF THE  
WHOLE GOVERNMENT, THE CAPABILITY OF THE GOP TO IMPLEMENT  
AND ENFORCE THE MEASURES IS QUESTIONABLE.

7. IN SUM, SPEECH PRODUCED MUCH OF THE SAME -- IT WAS  
LONGER ON WORDS THAN ON IMMEDIATE ACTION OR DETAILS.  
SOARES CONTINUES TO ATTEMPT TO CREATE THE RIGHT PSYCHO-  
LOGICAL CLIMATE UNDER WHICH HE CAN IMPLEMENT NECESSARY  
MEASURES. ECONOMIC POLICY DIVISION WITHIN THE  
PS, THE LACK OF AN OUTSTANDING ECONOMIC TEAM, ANTI-  
GOVERNMENT ACTIVITIES AND THE SPECTER OF THE UPCOMING  
ELECTIONS MAKE IMPLEMENTATION DIFFICULT. EVEN THE

LIMITED MEASURES HE ANNOUNCED HAVE ALREADY SPARKED  
SEVERE CRITICISM FROM THE COMMUNISTS. AT THE SAME  
TIME, EANES AND HIS MILITARY SUPPORTERS ARE PRESSING  
FOR MORE DRASTIC ACTIONS. SOARES' IN EFFECT, HAS A  
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PAGE 04 LISBON 06203 03 OF 03 101539Z

NARROW, DIFFICULT PATH TO FOLLOW. UNTIL HE TAKES DRA-  
MATIC IMPLEMENTATION MEASURES, THE ECONOMY WILL CON-  
TINUE TO STAGNATE; HOPEFULLY THESE WILL BE FORTH-  
COMING SOON. TIME IS NOT ON HIS SIDE.

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